Petition

81-1896

No.

Supreme Court, U.S.
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ALEXANDER L. STEVAS
CLERK

IN THE

SUPREME COURT OF THE UNITED STATES

October Term, 1981

JAMES A. HALIKAS, M.D.,
Executive Director - - - - - Petitioner

versus

RIVER REGION MENTAL HEALTH-MENTAL RETARDATION BOARD, INC., Et. Al. - - - - - Respondents

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PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SIXTH CIRCUIT

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QUESTION PRESENTED FOR REVIEW

Whether a quasi-municipal corporation such as [in this case] an incorporated mental health-mental retardation board, is entitled to:

(1) Ordinary relief under the bankruptcy act (Chapters I-VII and XI); or

(2) Relief only under "adjustment of debts of political subdivisions and public agencies and instrumentalities" (Chapter IX).

PARTIES

River Region Mental Health-Mental Retardation Board, Inc.

River Region Mental Health-Mental Retardation Board.

Wallace A. Spaulding, Jr., Trustee in Bankruptcy.

Commonwealth of Kentucky, ex rel Department for Human Resources.

Seven Counties Services, Inc.

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IN THE

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October Term, 1981

No._____

JAMES A. HALIKAS, M.D. - - - *Petitioner,*

v.

RIVER REGION MENTAL HEALTH-MENTAL RETARDATION BOARD, INC., Et Al. - *Respondents.*

PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SIXTH CIRCUIT

To the Honorable Chief Justice and Associate Justices of the Supreme Court of the United States:

James A. Halikas, M.D., Executive Director of the Petitioner in Bankruptcy (hereinafter "River Region"), by his counsel, respectfully prays that a Writ of Certiorari issue to review the decision of the United States Court of Appeals for the Sixth Circuit filed on October 22, 1981.

OPINIONS BELOW

The interloctuory order of the Bankruptcy Court for the United States District Court for the Western District of Kentucky (hereinafter "Bankruptcy Court") recognizing ". . . that River Region, as a non-profit quasi-public corporation, specifically created

to provide certain services to this community, must be treated differently than a profit-oriented, private business who seeks relief under Chapter XI of the Act", dated March 15, 1978, is printed at pages A-1 to A-6, *infra,* and is not officially reported. The Bankruptcy Court's memorandum and order overruling Halikas' motion [suggestion that the Bankruptcy Court lacked subject matter jurisdiction] and dismissing the complaint for non-dischargability, dated January 8, 1980, is printed at pages B-2 to B-11, and is not officially reported. The memorandum and order of the United States District Court for the Western District of Kentucky, affirming, filed September 11, 1980, is printed at pages C-1 to C-11, and is not officially reported. The order of the Court of Appeals for the Sixth Circuit, affirming, filed October 22, 1981, is printed at pages E-1 to E-3, and is not officially reported. The notice to counsel and order of the Court of Appeals for the Sixth Circuit, denying rehearing, filed January 12, 1982, is printed at pages F-1 to F-2 and is not officially reported.

JURISDICTION

The date of the order of the Court of Appeals for the Sixth Circuit sought to be reviewed is October 22, 1981 which is also the date of its filing. A motion for rehearing of that order was denied by an order of the Court of Appeals for the Sixth Circuit dated January 12, 1982. Jurisdiction of the Court is invoked under 28 U.S.C. §1254 and 11 U.S.C. §47.

STATUTES INVOLVED

BANKRUPTCY ACT

River Region was adjudicated a bankrupt on August 2, 1978, retroactive as of midnight, July 31, 1978. The relevant provisions of the bankruptcy act in effect as of the date of adjudication provide:

Regarding Chapters I - VII, *"Ordinary Bankruptcy"*, under Chapter III, §4(a) (former 11 U.S.C. §22)* states:

> § 4. Who May Become Bankrupts. a. Any person, *except a municipal,* railroad, insurance, or banking *corporation* or a building and loan association, shall be entitled to the benefits of this Act as a voluntary bankrupt. (emphasis added.)

Regarding Chapter IX *"Adjustment of Debts of Political Subdivision and Public Agencies and Instrumentalities":*

> SEC. 84. ELIGIBILITY FOR RELIEF.—Any State's political subdivision or public agency or instrumentality, which is generally authorized to file a petition under this chapter by the legislature, or by a governmental officer or organization empowered by State law to authorize the filing of a petition, is eligible for relief under this chapter if it is insolvent or unable to meet its debts as they mature, and desires to effect a plan to adjust its debts. §84 [former 11 U.S.C. §404(1976)]

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*The provisions of Chapter III §4(a) also apply to proceedings under Chapter XI "Arrangements" pursuant to Sec. 302 of the Bankruptcy Act (former 11 U.S.C. §702).

SEC. 85. PETITION AND PROCEEDINGS RELATING TO PETITION.—

(a) PETITION.—An entity eligible under section 84 may file a petition for relief under this chapter. In the case of an unincorporated tax or special assessment district having no officials of its own, the petition may be filed by its governing authority or the board or body having authority to levy taxes or assessments to meet the obligations of the district. §85 [former 11 U.S.C. §404 (1976)]

The bankruptcy provisions governing Adjustment of Municipal Corporate Debt were amended both immediately prior (1976) and immediately subsequent ("Bankruptcy Code" enacted November 6, 1978, generally effective October 1, 1979) to the subject adjudication;* the relevant provisions are set forth below for the convenience of the Court:

The pre-1976 version of Chapter IX §81 provided:

This Act and proceedings thereunder are found and declared to be within the subject of bankruptcies and, in addition to the jurisdiction otherwise exercised, courts of bankruptcy [limited to mean "the United States District Court or a judge thereof" B.R. 9-30(6)] shall exercise original jurisdiction as provided in this chapter for the composition of indebtedness of, or authorized by, any of the agencies or instrumentalities hereinafter named, payable (a) out of assessments or taxes, or both, levied against and constituting liens upon

*The history of Municipal Bankruptcy Legislation is provided at ¶900.01, *Collier On Bankruptcy* (15th Ed. Vol. 4 1981) "Municipal Bankruptcy Under the Code."

property in any of said agencies or instrumentalities; or (b) out of property acquired by foreclosure of any such assessments or taxes or both, or (c) out of income derived by such agencies or instrumentalities from any income-producing property whether or not secured by a lien upon such property: (1) Drainage, drainage and levee, reclamation, water irrigation, or other similar districts, commonly designated as agricultural improvement districts or local improvements districts, organized or created for the purpose of constructing, improving, maintaining, and operating certain improvements or projects devoted chiefly to the improvement of lands therein for agricultural purposes; or (2) local improvement districts, such as sewer, paving, sanitary, or other similar districts, organized or created for the purposes designated by their respective names; or (3) local government districts, such as road, highway, or other similar districts, organized or created for the purpose of grading, paving, or otherwise improving public streets, roads, or highways; or (4) public-school districts or public-school authorities organized or created for the purpose of constructing, maintaining and operating public schools or public-school facilities; or (5) local improvement districts such as port, navigation, or other similar districts, organized or created for the purpose of constructing, improving, maintaining, and operating ports and port facilities; or (6) incorporated authorities, commissions, or similar public agencies organized for the purpose of construction, maintaining, and operating revenue-producing enterprises; or (7) any county or parish or any city, town, village, borough, township or other municipality. §81 of

the Bankruptcy Act [former 11 U.S.C. §401 (1937, as amended 1946)]

The 1978 Bankruptcy Code, 11 U.S.C. §103, makes the general provisions, including the following definitions contained in 11 U.S.C. §101, applicable to Chapters 7, 9, and 11:

§ 101. Definitions. In this title—

(21) "governmental unit" means United States; State; Commonwealth; District; Territory; municipality; foreign state; department, agency, or instrumentality of the United States, a State, a Commonwealth, a District, a Territory, a municipality, or a foreign state; or other foreign or domestic government;

Legislative History

Paragraph . . . [21] defines "governmental unit" in the broadest sense. The definition encompasses the United States, a State, Commonwealth. District, Territory, municipality or foreign state, and a department, agency, or instrumentality of any of those entities. "Department, agency, or instrumentality" does not include entities that owe their existence to State action as the granting of a charter or a license but that have no other connection with a State or local government or the Federal Government. The relationship must be an active one in which the department, agency, or instrumetality is actually carrying out some government function. Houth Report No. 95-595, 95th Cong. 1st Sess. (1977) 311; *See* Senate Report No. 95-989, 95th Cong. 2d Sess. (1978) 24.

* * *

(29) "municipality" means political subdivision or public agency or instrumentality of a State;

Legislative History

Paragraph . . . [29] defines "municipality." The definition is adapted from the terms used in the chapter IX (municipal bankruptcy) amendment to the Bankruptcy Act enacted in 1976 (Pub. L. 94-260). That amendment spoke in terms of "political subdivision or public agency or instrumentality of a State." Bankruptcy Act Section 84. The term municipality is defined by those three terms for convenience. House Report No. 95-595, 95th Cong. 1st Sess. (1977) 312-13; Senate Report No. 95-989, 95th Cong. 2d Sess. (1978) 25.

* * *

(30) "person" includes individual, partnership, and corporation, but does not include governmental unit;

Legislative History

"Person" is defined in paragraph . . . [30]. The definition is a change in wording, but not in substance, from the definition in section 1(23) of the Bankruptcy Act. The definition is also similar to the one contained in 1 U.S.C. §1, but is repeated here for convenience and ease of reference. Person includes individual partnership, and corporation. The exclusion of governmental units is made explicit in order to avoid any confusion that may arise if, for example, a municipality is incorporated and thus is legally a corporation as well as governmental unit. House Report No. 95-595, 95th Cong. 1st Sess. (1977) 313; Senate Report No. 95-989, 95th Cong. 2d Sess. (1978) 25.

CONSTITUTION OF THE UNITED STATES

Article I, Section 8, Clause 4, states:

> The Congress shall have the Power . . . to establish an . . . uniform Law[s] on the subject of Bankruptcies throughout the United States.

Article I, Section 10, Clause 1, states:

> No state shall . . . pass any . . . law impairing the obligation of contracts . . .

Amendment 10 states:

> The powers not delegated to the United States by the Constitution, nor prohibited by it to the States, are reserved to the States respectively, or to the people.

STATEMENT OF THE CASE

On February 23, 1978, River Region, an incorporated Mental Health-Mental Retardation Board with both public and private characteristics, filed a petition for an Arrangement under Chapter XI of the Bankruptcy Act, stating in relevant part:

> I. River Region Mental Health-Mental Retardation Board, Inc. ("River Region") is a nonprofit corporation formed under the provisions of Chapter 273 of the Kentucky Revised Statutes. River Region acts as an administrator of a Regional Community Mental Health Program, pursuant to KRS 210.370, et seq., which provides for such programs and permits such a program to be admin-

> istered by a non-profit corporation. Pursuant to KRS 210.380, River Region is required to select a community mental health board to oversee the administration of the Regional Community Mental Health Program. The Board of Directors of River Region are simultaneously trustees of the nonprofit charitable corporation, and simultaneously the same invididuals making up the Board of River Region also constitute the Community Mental Health Board required by KRS 210.380.

Early on, the Bankruptcy Court recognized the quasi-municipal character of River Region and effected special treatment for purposes of the Chapter XI administration. For example, in its order of March 15, 1978, the Bankruptcy Court stated:

> The Commonwealth of Kentucky, as the primary funding agency of the debtor, should be intimately concerned with the efforts of River Region to solve its financial difficulties. Its unwillingness to continue funding the debtor in the absence of certain assurances certainly is within the purview of sound public financial management.
>
> Nevertheless, the concern by the Commonwealth should not result in the circumvention of the Bankruptcy Act and its Rules. *The Court recognizes that River Region, as a non-profit, quasi-public corporation, specifically created to provide certain services to this community, must be treated differently than a profit-oriented, private business who seeks relief under Chapter XI of the Act.* The sources of River Region's income, governmental grants, as opposed to income derived from the selling of services or products, further removes

> the debtor from the rehabilitation procedures contemplated by the Act. (See Appendix A-2) (emphasis added)

No Chapter XI Plan was ever formulated and presented; instead, on June 29, 1978, Kentucky's Department for Human Resources announced its own plan to (1) "withdraw designation" of River Region as the authority for delivering community mental health and mental retardation services to Louisville and the six surrounding counties; and (2) designated a newly formed and nearly identical corporation, Seven Counties Services, Inc., as the Regional Authority. (See Appendix G).

On August 2, 1978 (retroactive to July 31, 1978), upon motion of River Region and notwithstanding objection that the petition belonged, if anywhere, under Chapter IX, River Region was adjudicated a bankrupt. On November 21, 1978, the subject complaint was filed, stating in relevant part:

> That River Region Mental Health-Mental Retardation Board, Inc., hereinafter "River Region", is an entity properly classified under "incorporated authorities, commissions, or similar public agencies organized for the purpose of constructing, maintaining, and operating revenue-producing enterprises"; § 81, 11 U.S.C.A. 401 (6). River Region was clearly formulated, organized and operated exclusively by and for the Commonwealth of Kentucky and is nothing more than the alter-ego and surrogate of the Kentucky Department for Human Resources. Current proceedings under § 321, 11 U.S.C.A. 721, and subsequent ad-

> judication as bankrupt therefore fail, as River Region is not an intended "debtor' 'under § 306 [sic], 11 U.S.C.A. 706, and adjudication of this State Agency as a bankrupt would be improper. [The above citations refer to the Bankruptcy Act, former 11 U.S.C. in effect July 31, 1978].

On January 8, 1980, after a bifurcated trial, the Bankruptcy Court entered its memorandum and order dismissing the complaint (See Appendix B) in which it noted that River Region was operated both pursuant to Kentucky Revised Statutes, §210.370 *et seq.* ["Regional Community Mental Health Program"] and as a nonprofit charitable corporation formed under Chapter 273 of the Kentucky Revised Statutes to administer a seven county community mental health-mental retardation program. The Bankruptcy Court made a jurisdictional distinction between River Region as a Regional Mental Health-Mental Retardation board and River Region as a non-profit corporation, noting:

> . . . "this corporate entity alone filed for the protection of the Bankruptcy Act." (See Appendix B-3)

The Bankruptcy Court further held in its order of January 8, 1980:

> In order for the previous adjudication of River Region as a bankrupt to be vacated, it would be necessary to find that this entity was in reality a state agency or instrumentality, having to file a petition under Chapter IX of the Bankruptcy Act, providing for the adjustment of debts of political subdivisions and public agencies and instrumentalities . . . (See Appendix B-4)

Neither the Bankruptcy Court in its final order, nor the two reviewing appellate courts in their respective affirming orders, addressed this troublesome issue of "into what shaped hole does a quasi-municipal corporate peg fit?" The Bankruptcy Court merely concluded that since River Region did "not constitute a state agency or instrumentality" its Chapter XI petition was properly filed and converted into a Chapter IV proceeding. With substantially identical reasoning, the District Court affirmed on September 11, 1980 (Appendix C) and on October 22, 1981 the Court of Appeals for the Sixth Circuit affirmed without comment. (Exhibit E).

On March 12, 1981, during the pendency of the Sixth Circuit Appeal, Halikas had filed a motion challenging the Court of Appeals' own subject matter jurisdiction together with a lengthy memorandum and exhibits (over 800 pages) with the Court of Appeals, arguing that River Region is a quasi-municipal corporation, etc., and demonstrating beyond a shadow of doubt that the statutory purpose and actual function of River Region is municipal—notwithstanding its nonprofit corporate articles (the only evidence offered in defense of River Region's argument that it is private). On April 21, 1981, the Court of Appeals reserved judgment on this motion and, by implication, overruled it by entry of the October 22, 1981, order, affirming.

In his November 20, 1981, petition for rehearing [Styled "Petition For Clarification, Amplification

And/Or Reconsideration"] Executive Director Halikas argued:

> This case involves one or more questions of exceptional importance inasmuch it is public knowledge in Kentucky that similar incorporated Mental Health-Mental Retardation Boards are continuing to experience such extraordinary financial crises that serious proposals of merger of these boards with other public health boards have been published . . . ; in addition, other quasi-public organizations, such as Louisville University Hospital (formerly General Hospital) are in financial crisis similar to that experienced by River Region . . . This Court must take judicial notice of these public financial disasters and of the fact that these public corporations are owned, operated, and are for the exclusive benefit of the public; further that both the public nature of these corporations and their potential collapse is of widespread public knowledge . . . If this Court's Order of October 22, 1981 is allowed to stand, these other Mental Health-Mental Retardation Boards, Public Health Boards, Hospital Districts, Irrigation Districts, etc., will be denied their traditional relief under Chapter IX and will be encouraged to unilaterally file petitions in Bankruptcy Court without authorization from their respective legislatures. This result would be a significant deviation from all cited authorities.

In the event rehearing was denied, Halikas further begged the Court of Appeals [in order that this petition for writ of certiorari could be fairly presented to this Court] to clarify and/or amplify its October 22,

1981 order by making and entering either of the following findings which would be consistent with affirmation:

Finding of Fact:

1. River Region is not a quasi-municipal corporation.

Conclusion of Law:

2. A quasi-municipal corporation is not a "municipal corporation" as intended under Chapter III Section 4 of the Bankruptcy Act; therefore even if River Region were quasi-municipal, it would be entitled to bankruptcy relief by discharge.

On January 12, 1982, the Court of Appeals concluded that Halikas' motion for rehearing ("Clarification," etc.) was without merit and denied.

ARGUMENT

Classification As "Quasi-Municipal Corporation"

It is plain enough, from the March 15, 1978 Order [Recognizing River Region as a Non-Profit, Quasi-Public Corporation] and from the Findings of Fact in the January 8, 1980 Memorandum and Order, that the Bankruptcy Court classified River Region as quasi-municipal; but that notwithstanding this quasi-municipal (quasi-public) characterization, the Bankruptcy Court held that the petition was properly filed in that the non-profit corporate entity alone (as opposed to the "Regional Board") had filed for the protection of the Bankruptcy Act.

It is respectfully submitted that this fractured, disjunctive approach is fundamental error in light of the overwhelming evidence that the "Regional Board" and the "Non-Profit Corporation Board" both were constituted and functioned simultaneously;* as stated in River Region's Petition:

> The Board of Directors of River Region are simultaneously trustees of the nonprofit charitable corporation, and simultaneously the same individuals making up the Board of River Region also constitute the Community Mental Health Board required by KRS 210.380.

River Region is clearly one entity, albeit quasi-private and quasi-public; and the question presented is how this quasi-municipal entity is to be classified under the Bankruptcy Act.

It is axiomatic that the character of an entity must be considered in light of the relief sought from the Court. Rules for Classification of "excluded classes" under Chapter III §4, are summarized in a leading bankruptcy treatise:

> Classification of Excluded Corporations: There appear to be no clear rules for determining whether a particular corporation falls within the defi-

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*The undersigned counsel has been unable to locate any legal precedent where an incorporated public body attempted to "sever" and bankrupt its non-profit corporate shell while "re-designating" the municipal function to a new non-profit corporation; however the legislative history to the 1978 Bankruptcy Code, 11 U.S.C. §101(30) [reproduced herein at p. 7] indicated congressional concern with possible confusion over this same issue.

> nition of these excluded corporations. *Two available approaches to the problem have been suggested and used at times by the Courts: (1) a classification based upon the law of the State of incorporation, and (2) an independent classification by the Bankruptcy Courts based upon their own definition of the words of the Bankruptcy Act.* Although the first mentioned of these approaches, commonly called the 'state classification test', is more favored by the Courts, this does not mean that state law is followed literally without regard for the real activities of the corporation, particularly where the corporation has failed to utilize its character or has developed into a different type of corporation. 1 Collier on Bankruptcy, § 4.05(2) (14th ed. 1974) (emphasis added)

In a cornerstone case which applied the state classification test in holding that an alleged "investment association" was an insurance company excluded from bankruptcy relief, an examination of the constitutional issues requiring exclusion of these classes of corporations is provided:

> *But we must still determine what reasons led Congress to exclude municipal,* railroad, insurance and banking *corporations from the purview of the Act,* and what interpretation should be given to the excepting clause. . . . The purpose of the exclusion, we think was correctly described by Judge Sibley in the following passage from In Re: Supreme Lodge of the Masons Annuity, DC ND, CA., 286 F. 180, 184, which has found wide acceptance in the federal courts. . . . No reasons for making these exceptions were assigned by the com-

> mittees of Congress, *but they may be surmised to lie in the public or quasi-public nature of the business,* involving other interests than those of creditors, and the desirability of unarrested operation, the completeness of state regulation, including provisions for insolvency, and the inappropriateness of the bankruptcy machinery to their affairs.
>
> * * *
>
> . . . All except municipalities are companies for profit whose businesses are now generally regarded as 'affected with a public interest'; that is to say, as touching enough persons who must deal with them at some economic disadvantage, to require public supervision and control. *And municipalities are even more directly within public control.* The most natural inference is that Congress meant to leave to local winding-up statutes the liquidation of such companies; that since the states commonly kept supervision over them during their lives, it was reasonable they should take care of their demise. (emphasis added) *Simms* v. *Fidelity Assurance Ass'n.,* 129 F. 2d 442, 448-449 (4th Cir. 1942)

The undersigned counsel has been unable to find any published precedent involving a controverted voluntary petition in bankruptcy by a "quasi-municipal corporation"; it is respectfully submitted that this paucity of case law is a result of: (a) the fundamental constitutional constraints and explicit prohibitions contained in the Bankruptcy Act; (b) the glaring fact that a quasi-municipal corporation has even a more obvious "public nature" than the other classes of ex-

cluded corporations; and (c) what is commonly gleaned from a reading of Chapter IX "Adjustment of Debts of Political Subdivisions and Public Agencies and Instrumentalities" and its common law interpretations that *the only relief available to quasi-municipal corporation is under Chapter IX.*

There is, however, ample legal precedent in which voluntary bankruptcy petitions by members of the other classes of corporations excluded by Chapter III § 4 have been successfully challenged on the basis that the Bankruptcy Court lacked subject matter jurisdiction—holding that the respective petitioners were an excluded railroad, insurance, banking corporation, or building and loan association. 1 *Collier on Bankruptcy* § 4.05(2) page 587 (14th ed., 1974). Applying the tests announced in these cases it is clear that any "Quasi-Municipal" or "Quasi-Public" corporation, including River Region, is a "municipal corporation" as intended by the Bankruptcy Act under *both* the "Federal Classification Test" and the "State Classification Test."

Federal Classification Test:

In addition to the Bankruptcy Court's own classification of River Region as quasi-municipal ("quasi-public"), Federal classification has been expressly provided under Chapter IX of the Bankruptcy Act. This Court is respectfully urged to consider the history of Chapter IX and the gravity of the policies and delicate balance of power behind *Ashton* v. *Cameron County W. I. District,* 298 U. S. 513, 56 S. Ct. 892,

80 L. Ed. 1309 (1936) and *United States* v. *Bekins*, 304 U. S. 27, 58 S. Ct. 811, 82 L. Ed. 1137 (1938); the Court is also urged to consider in its deliberations the effect of allowing any quasi-municipal corporation to bankrupt its obligations as opposed to "adjustment" of its municipal debts.

Limitation of subject matter jurisdiction of this Article I Bankruptcy Court must be strictly construed. The whole foundation of "constitutionally limited government" would be rocked by a Bankruptcy Court's interference with the financial affairs of any public agency, instrumentality, or subdivision of state government—particularly in the absence of consent of the sovereign state!*

It is abundantly clear from the *Ashton* and *Bekins* cases, *supra*, that the only constitutionally permissible interference with the debts of a quasi-municipal corporation lies within the exclusive framework of Chapter IX "Adjustment of Municipal Debt"—as opposed to the "discharge" prayed for by River Region.

The pre-1976 version of Chapter IX, § 81, former 11 U.S.C. § 401 (1937, as amended 1946) specifically enumerated Chapter IX eligibility for every conceivable type of quasi-municipal corporation; this was broadened by the 1976 Amendments. [See "Statutes Involved" for full text]

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*There is at least one other appeal pending before the Supreme Court regarding the constitutionality of Article I Bankruptcy Courts under the code, which this case may help distinguish. [Constitutionality is not in issue here because Chapter IX of the Bankruptcy Act (as opposed to Chapter 9 of the Bankruptcy Code) required the additional safeguard of an Article III Court.]

By analogy the 1978 Bankruptcy Code 11 U.S.C. Sec. 101 "General Provisions," makes it crystal clear that Congress remains determined that these remedies be mutually exclusive: [a] "person [eligible for discharge] includes individual, partnership, and corporation, but does not include governmental unit" (*Id.* at §30); "governmental unit means . . . municipality" (Id. at §21); "municipality means political subdivision or public agency or instrumentality of a State" (*Id.* at §29). (emphasis added). Thus, while the (new) bankruptcy code does not employ the words "quasi-municipal," it is at least clear that under the code "municipality" means "municipal corporation" in the general sense, i.e. "public corporation" as opposed to "municipal proper" or "city."*

State Classification Test:

All three branches of government of the Commonwealth of Kentucky have classified entities similar to River Region as some form of municipal corporation—and would undoubtedly classify River Region as at least quasi-municipal:

1. Executive Branch

1. Executive Branch

(a) Executive Orders: Both Governors during whose administrations River Region was formed believed that River Region was a state agency so directly tied to the central state government that River

*A related issue is discussed *In Re: American Atomics Corporation* (1980 BC Ariz.) 5 BCD 1304.

Region's employees were *required* to participate in the Kentucky Employees Retirement System; in 1974 the Court of Appeals of Kentucky held that the incorporated MH-MR Boards were not ". . . departments, boards or agencies that are such integral parts of state government as to come within regular patterns of administrative organization and structure and to be subject to standard personnel policies having general application in the administration of government" and therefore participation by River Region in K.E.R.S. was held to be permissive and not mandatory.* *Ky. Region Eight* v. *Commonwealth of Kentucky,* 507 S. W. 2d 489, 491 (Ky. 1974). [However, it is noted that River Region subsequently elected K.E.R.S. and participation in the Kentucky Employment Retirement System was mandatory for all River Region employees hired after August 1, 1974.

(b) Attorney General Opinions

Since 1969 Kentucky's Attorney General has argued on behalf of the commonwealth that the fifteen (15) incorporated Mental Health-Mental Retardation Boards of Kentucky, including River Region, are: [a] A state *"agency" or "department"* within the contemplation of the Kentucky Retirement System Law (OAG 60-314); [b] Are *limited agencies* of the

*Halikas does not contend that River Region is necessarily a "pure" state agency (meaning "Department") in the regular pattern of administrative organization and structure — only that it is a Municipal Corporation and therefore public agency or instrumentality of the state.

state and that their administrative costs are proper county expenses; also that they are *"public agencies* serving a public purpose, operating from state and local tax monies" . . . and "are in effect *public boards"* (OAG 70-466); [*c*] ". . . clearly are *instrumentalities* of the Commonwealth and therefore are a *political subdivision* for purposes of KRS 61.420" (OAG 73-203); [*d*] (In a 1976 opinion letter to River Region's present counsel) that they are *public agencies* under the Open Records Law. KRS 61.805 et seq. (OAG 76-648).

2. Legislative Branch

(a) *Kentucky Revised Statutes:* By the Kentucky Revised Statutes in effect on the date of adjudication, July 31, 1978, River Region is classified as a "Mental Health-Mental Retardation *Board* (KRS 210.370 and 210.380; an *"Administrative Authority"* (KRS 210.-400(6)); and a *"taxing district and board"* (KRS 210.470).*

In addition to the statutory classification as "board, taxing district, and administrative authority", Kentucky statutes vest virtually all control over River Region in the Department for Human Resources: The River Region Board was required to oversee and be responsible for the management of the community mental health and mental retardation program for the

*Section 175 of the Constitution of Kentucky provides that the power to tax property shall not be surrendered; see also "The assets and properties of a local taxing district may not be disposed of as in ordinary bankruptcy proceedings for the benefit of the debtor." 8B C.J.S. "Bankruptcy" §726 (1963).

entire seven county area "in accordance with . . . the policies and regulations issued by the Secretary of DHR (KRS 210.400). The Secretary of DHR was "authorized" to make state grants and other fund allocations (KRS 210.410); however River Region's program would not be eligible for any state grants or other fund allocations unless its plan and budget had been approved by DHR's Secretary (KRS 210.430); and most importantly, *the Secretary of DHR had the right to withdraw any such funds* as were unencumbered if River Region was not being operated in accordance with the policies and regulations of DHR; further he could *withdraw recognition* of River Region as local authority, appoint a caretaker administrator and/or *make whatever personnel changes* which he deemed necessary (KRS 210.440). [This "purse string control is clearly the 'power of visitation', a power which in this country is by the government itself, through the medium of Courts of Justice", *Hager* v. *Kentucky Children's Home Society,* 119 Ky. 235, 83 S. W. 605 (1904); further "the power to remove an administrative officer is an incident of the sovereign power" 73 C.J.S. *Public Administrative Bodies,* §13 (1951)].

(b) *Kentucky Administrative Regulations:* The Kentucky Administrative Regulations say as much by their bulk as they do by the specificity of their content, in demonstrating DHR's *actual control* over River Region.

These Regulations demonstrate that Central State Hospital, administered by River Region as "River Region Hospital" was a state mental *hospital district*

(DMH-11, filed May 27, 1966); that regional mental health centers were *controlled* by the Kentucky "manual of operating procedures for regional mental health centers" (DMH-15, filed December 5, 1968); that "for purposes of carrying on the delegated regional responsibilities of the Department of Mental Health, these regional mental health boards became the *local authority*" (DMH-16, filed August 7, 1969); the Division of Regional Services of DHR was to receive and *maintain personnel files* on River Region employees (DMH-18, filed December 23, 1969); that "male persons whose involuntary hospitalization is ordered and who are in custody . . . shall be admitted directly to District II, Central State Hospital (later "River Region Hospital") (DHM-20, filed August 7, 1970); that DHR *controlled* by regulation *membership criteria for the River Region Board* and government advisory council (DHM-25, filed January 19, 1971); that "inmates of state penal and correctional institutions transferred to the Department of Mental Health shall be admitted to District II—Central State Hospital" (later River Region Hospital) (DMH-26, filed August 17, 1971); that persons convicted of Dangerous Drug Act offenses shall be ordered to . . . Region 6 (River Region) (DMH-27, filed January 7, 1972); that the DHR *had the authority to set the standards and regulate the personnel files* for each of the three CMHC's administered by River Region (902 KAR 6:020, effective July 11, 1975); that (specifically named) *River Region Hospital is a state institution* (902 KAR 6:020, effective July 11, 1975); that River Region was "to act as the *authority for*

planning and administration of grants for all local programs relating to mental health, mental retardation, alcohol and drugs: "The purpose of this regulation is to provide for recognition of regional MH-MR boards as the *local authority for carrying out delegated responsibilities* and to insure compliance with applicable policies issued by DHR" (902 KAR 6:010, effective February 2, 1977); that River Region Hospital was a *state institution* for the mentally ill, for each county in its district (902 KAR 6:040E, effective March 16, 1977); that the Secretary of DHR was *required to allocate funds to River Region out of its general funds* (902 KAR 6:050E, effective June 30, 1978).

3. Judicial Branch — Case Law of Kentucky

Although not previously considered by the Kentucky Courts, it is clear that application of the common law of Kentucky requires classification of River Region as a municipal corporation in the general sense and at the very least, a quasi-municipal corporation. For example it has been held: "Central State Hospital [the same Central State administrated by River Region] is a state institution and exercises part of the sovereign functions of the state government." *Dunn* v. *Central State Hospital,* 197 Ky. 807, 248 S. W. 216 (1923); the Columbian Exposition board was both a corporation and a state agency; "its character depends on the powers given it". *Gross* v. *Kentucky Board of Managers of World's Columbia Exposition,* 105 Ky. 840, 49 S. W. 458 (1899); "taxing districts and other incorporated governmental agencies of the state, while they may not be technically qualified as municipal

corporations, are at least quasi ones . . ." *Board of Education of City of Newport* v. *Scott,* 189 Ky. 225, 224 S. W. 680 (1920); a Board of Education is performing a state function and is a political subdivision and arm of state government. *Cullinan* v. *Jefferson County,* 418 S. W. 2d 407 (Ky. 1967); the Kentucky State Park Commission is a department, board, agency or commission of the state. *Kentucky State Park Commission* v. *Wilder,* 256 Ky. 313, 76 S. W. 2d 4 (Ky. 1934); the Eastern Kentucky Lunatic Asylum was a state institution on the grounds that ". . . the care of the poor unfortunate ones confined in the institution . . . is a governmental duty". *Ketterer's Administrator* v. *State Board of Control,* 131 Ky. 287, 115 S. W. 200 (1909); "such institutions (the Western Kentucky Asylum) are mere instrumentalities of state government brought into being to aid in the performance of governmental duty . . .". *Leavell* v. *Western Kentucky Asylum for the Insane,* 122 Ky. 213, 91 S. W. 671 (1906); the Louisville and Jefferson County Board of Health is a municipal corporation. *Stephenson* v. *Louisville and Jefferson County Board of Health,* 389 S. W. 2d 637 (Ky. 1965); "it is sufficient to say that an asylum, (Western State Hospital) created and maintained at the expense of the State for the care of the insane is a mere instrumentality of the state government brought into being to aid in the performance of a governmental duty. . .". *University of Louisville* v. *Metcalfe,* 216 Ky. 339, 387 S. W. 945 (Ky. 1926); "the Louisville Industrial School of Reform was created a body corporate by an act of the general assembly. . . . It was a charity and its purpose was

reformation . . . the incorporators and their successors are under the oversight of the legislature and are mere instrumentalities of the Commonwealth . . . It was an agency of the state, and maintained by taxation and state aid . . . The functions of the institution are governmental." *William* v. *Louisville Industrial School of Reform,* 95 Ky. 251, 24 S. W. 1065 (1894).

In a recent case holding that a County Public Improvement Financing Board is a "municipality" it is stated:

> There is nothing extraordinary in the concept that a Board of the kind here involved is a municipality, because in addition to the holding in Brown v. Board of Education, 108 Ky. 783, 57 S. W. 612, that a City School Board is a municipality there have been similar holdings as to a Sewer Board, Rash v. Louisville and Jefferson County Metropolitan Sewer District, 309 Ky. 442, 217 S. W. 2d 232, and an Airport Board, Louisville and Jefferson County Airboard v. American Airlines, Ky. D.C., 160 F. Supp. 771. *E.P. Sawyer* v. *Jefferson County Fiscal Court,* 438 S. W. 2d 531 (Ky. 1969)

Finally, the common law of Kentucky regarding municipal corporations was summarized in a recent case:

> We find nothing in the Constitution which requires that subdivision of local government be limited to cities and counties.
>
> * * *
>
> *We have heretofore approved the establishment of municipal improvement districts and sewer dis-*

> *tricts and have recognized them as forms of municipal corporations.* Lowery v. County of Jefferson, Ky. 458 S. W. 2d 168 (1970); Fawbush v. Louisville and Jefferson County Metropolitan Sewer District, Ky. 240 S. W. 2d 622 (1951); Rash v. Louisville and Jefferson County Metropolitan Sewer District, 309 Ky. 442, 217 S. W. 2d 232 (1949). Our statutes authorize a great variety of other districts such as water districts, fire prevention districts, and library districts. *Holsclaw* v. *Stephens,* 507 S. W. 2d 462 (Ky. 1974) (emphasis added)

In summary, it could not be more clear than that *all three branches of Kentucky government classify River Region as some form of municipal corporation* and would undoubtedly classify it as, at least, "quasi-municipal".

Why The Court Should Grant Certiorari

By its order of October 22, 1981, the United States Court of Appeals for the Sixth Circuit has decided an extremely important question of federal law which has not been, but should be settled by this court. The widespread use of quasi-municipal corporations to to perform public functions is a relatively recent phenomenon; in these uncertain economic times, the Court of Appeals' order creates a dangerous precedent which may encourage other quasi-municipal corporations to bankrupt their corporate shells and simply redesignate their public function to a newly formed quasi-municipal corporation.

In addition, the Sixth Circuit's October 22, 1981 order decides this federal question in a way which con-

flicts with this Court's decisions in *Ashton* v. *Cameron County Water Improvement District,* 298 U. S. 513, 56 S. Ct. 892, 80 L. Ed. 1309 (1936) and *United States* v. *Bekins,* 304 U. S. 27, 58 S. Ct. 811, 82 L. Ed. 1137 (1938) which jealously restrict subject matter jurisdiction of municipal corporations to Chapter IX relief. Also, a natural corollary to the Sixth Circuit's decision acquiescing to River Region's bankruptcy is its acquiescence to a successor municipal corporation (Seven Counties Services, Inc); this squarely conflicts with this Court's decision in *Port of Mobile* v. *Watson,* 116 U. S. 289, 6 S. Ct. 398 (1886).

The Sixth Circuit's October 22, 1981 decision is also in conflict with the reasoning of the Court of Appeals for the Fourth Circuit, *Simms* v. *Fidelity Assurance Ass'n.,* 129 F. 2d 442 (4th Cir. 1942); and while the Bankruptcy Code of 1978 does eliminate some ambiguity by careful definition and use of the term "Governmental Unit", the code provides the same "dovetailing" of mutually exclusive remedies for private and public corporations. Judicial construction of this issue under the Bankruptcy Act would therefore be timely and would provide substantial guidance to other quasi-mutual corporations contemplating relief under the Bankruptcy Code.

But perhaps most importantly, this case offers an opportunity to employ this Court's announced policy, to pre-empt needless complex litigation in the lower courts by reviewing this narrow issue construing the Constitutional limitations of bankruptcy relief available to quasi-municipal corporations.

CONCLUSION

As indicated by the footnotes to the District Court's memorandum and order of September 11, 1980, the Bankruptcy Record appeared unduly voluminous and the confused proceedings in the Bankruptcy Court were, at times, less than orderly.

It is most respectfully suggested that the cause of this confusion is simple: any composition or adjustment of debts of any public or municipal corporation, including quasi-municipal corporations which are vested with public function, demand the special procedure and Constitutional restraints so carefully drawn into Chapter IX. The frustration of the Bankruptcy Court arose out of uncertainty as to how to treat the largest bankruptcy estate ever presented to the Western District of Kentucky — particularly in the face of continuous reassertion of control and various well-intended demands by the Commonwealth of Kentucky, seeking to assure continuity in the provision of essential public services.

Irrespective of how this Court ultimately rules on this case of first impression, Certiorari should be granted to provide a clear roadmap and a truly uniform law on the subject of bankruptcies as it affects our public corporations.

Respectfully submitted,

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(502) 589-6060
Counsel for Petitioner

Appendix

APPENDIX A

UNITED STATES DISTRICT COURT

FOR THE WESTERN DISTRICT OF KENTUCKY

CHAPTER XI

No. BK 78-00193-L

IN RE:

RIVER REGION MENTAL HEALTH-MENTAL RETARDATION BOARD, INC.—Debtor

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ORDER

This Chapter XI case is before the Court on motions for the employment of legal counsel for the debtor-in-possession, for approval by this Court of a contract previously entered into between River Region and Hospital Management Associates on the 9th day of March, 1978, and on motions of certain employee-creditors for a hearing on certain contractual commitments either "presently entered into or contemplated by the debtor", and for any and all pertinent documents concerning the employment contract between the debtor and its Executive Director, Dr. J. A. Halikas.

On February 23, 1978, River Region Mental Health-Mental Retardation Board, Inc. (River Region) filed an original voluntary petition for arrangement of its debts pursuant to Chapter XI of the Bankruptcy Act. Thereafter, in response to the numerous motions filed, a conference between the movants was directed to be held on March 13, 1978.

The concern expressed by the Court with the contract previously executed between River Region and Hospital

Management Associates should not be construed to mean that the employment of a management firm was not in the best interest of the creditors; nor should the Court's comments be construed to imply that a management consultant is not necessary to the rehabilitation of the debtor; nor did the Court intend to intimate that Hospital Management Associates was not the proper company to be employed; nor should it be construed that the pressure exerted by the Commonwealth of Kentucky, through its Department of Human Resources, directing that the debtor enter into the contract in controversy was improper; but, what concerns the Court is the debtor's failure to properly consult it and obtain its approval.

The advisability of a management consultant contract in general, and specifically, the contract now before the Court for approval, can only be made at a later date after sufficient information has been made available to the Court.

However, the Court would be remiss if it allowed the Rules and Procedures of the Bankruptcy Act to be circumvented by the acts of others irrespective of how well intended. The Commonwealth of Kentucky, as the primary funding agency of the debtor, should be intimately concerned with the efforts of River Region to solve its financial difficulties. Its unwillingness to continue funding the debtor in the absence of certain assurances certainly is within the purview of sound public financial management.

Nevertheless, the concern by the Commonwealth should not result in the circumvention of the Bankruptcy Act and its Rules. The Court recognizes that River Region, as a non-profit, quasi-public corporation, specifically created to provide certain services to this community, must be treated differently than a profit-oriented, private business who seeks relief under Chapter XI of the Act. The sources of River Region's income, governmental grants, as opposed to income derived from the selling of services or products,

further removes the debtor from the rehabilitation procedures contemplated by the Act.

The authority of this Court to supervise and direct the affairs of a debtor seeking relief under Chapter XI is supreme and should be jealously guarded. Protection of this authority by the Court is not dictated by an authoritarian complex or other human frailty. For a Bankruptcy Court to voluntarily relinquish its control without a finding of good cause or to allow well intended acts of others to dilute its authority would not be in keeping with the spirit of the Act or the intentions of Congress. A financially distressed debtor under Chapter XI who seeks a composition or extension of its obligations with its unsecured creditors, thereby effecting a rehabilitation of its finances, is afforded certain immediate advantages. Specifically, some of these advantages are that creditors and federal and state taxing authorities are automatically restrained from instituting or continuing legal action against the debtor and from seizing its assets; burdensome executory contracts may be rejected; the debtor may normally continue operating its business without harassment from creditors. However, Chapter XI proceedings also harbor certain disadvantages, one of which is that the debtor must subject himself to the aegis and supervision of the Court. Consequently, it is imperative that the debtor who has obtained these advantages conferred by Congress does not fail to conform and comply with the Bankruptcy Act and its Rules, irrespective of its disadvantages.

River Region's financial distress, caused by many years of financial misdirection, specific causes of which have yet to be determined, cannot be resolved in a matter of days. The diverse groups, in their efforts to protect their respective interests, should be ever mindful that River Region's continued existence is dependent upon patience and confidence. Overreaction and emotional responses to serious

and complex problems will only cause further financial deterioration of the debtor.

WHEREFORE, this Court having considered the motions and arguments in support and opposition thereto, and being sufficiently advised,

IT IS HEREBY ORDERED AND ADJUDGED that River Region shall tender to the Court on or before March 24, 1978, a complete recital of the criteria used by River Region in negotiating its contract with Hospital Management Associates.

IT IS FURTHER ORDERED AND ADJUDGED that the motion to authorize a contract between River Region and Hospital Management Associates be, and is, taken under submission.

IT IS FURTHER ORDERED AND ADJUDGED that the debtor-in-possession shall provide to John F. Stewart, attorney for certain but unnamed creditors, pertinent documents concerning the employment of Dr. Halikas.

IT IS FURTHER ORDERED AND ADJUDGED that John F. Stewart shall file with this Court, on or before March 24, 1978, a statement setting forth the names of his clients, his authority to represent them, and any and all pertinent information concerning his employment.

IT IS FURTHER ORDERED AND ADJUDGED that the debtor-in-possession be, and is, authorized to employ as co-counsel for the debtor the law firm of Greenebaum, Doll, Matthews & Boone, and John P. Reisz, at an hourly rate not to exceed Fifty Dollars and 00/100 ($50.00) per hour. Section 62(4)(c)., Bankruptcy Act, 11 U.S.C. § 120; Rule 219, Rules of Bankruptcy Procedure; *Cle-Ware Industries, Inc.* v. *Sokolsky*, 493 F. 2d 863 (6th Cir., 1974).

IT IS FURTHER ORDERED AND ADJUDGED that all other pending motions be, and are, taken under submission.

IT IS FINALLY ORDERED:

1. That the Management Service Agreement entered by and between River Region Mental Health-Mental Retardation Board, Inc. (River Region), the debtor-in-possession and custodian of the debtor's estate, and Hospital Management Associates, Inc. (HMA), (a copy of said agreement having been previously submitted to the Court) is hereby approved for interim implementation until said agreement or any other such agreement is finally approved, or rejected by the Court.

2. That HMA shall be compensated for its work actually done during said interim period, at the rates set forth in said agreement.

3. That during the period of this interim Order and retroactive to date HMA commenced performance pursuant to said agreement HMA shall generally have the powers as set forth in said contracts, as expanded or limited below, as follows:

(a) HMA shall not lay off, fire or otherwise terminate employees pursuant to a general reorganization of River Region prior to the first meeting of creditors; however, such prohibition shall not preclude HMA, as agent for River Region, or River Region, from day-to-day dismissal of employees for cause or other employee disciplinary action in the ordinary course of business.

(b) That HMA be given the authority to monitor all purchase orders, or requests, and approve or reject same.

(c) That HMA be given the authority to open new bank accounts, with signature authority over same, so as to allow HMA to account for its management of River Region during the interim period.

(d) That HMA be given the authority to impose a hiring freeze at River Region, except to the extent it deems necessary.

(e) That HMA shall have authority to provide for the general security of the property, plant and other assets of River Region, including, but not limited to, where indicated, the changing of locks.

(f) That HMA be allowed to name itself as an additional insured under various liability insurance contracts presently held by River Region.

(g) That HMA be allowed to implement a freeze on all wage and salary increases for employees at River Region.

4. HMA, pursuant to this Order, shall be available on request to report and account to the Board of Directors of River Region, to this Court, and if requested, to the first meeting of creditors, and to take such other action as may be further directed by the Court.

A copy of this Order is mailed to Alex P. Humphrey and John P. Reisz, co-counsel for the debtor; to Robb L. Smith; to John F. Stewart; to Richard Clay; to Charles Middleton; to James Moyer; and to Robert Riley.

(s) Stewart E. Bland
Bankruptcy Judge

Louisville, Kentucky
March 15, 1978 kc

cc: Joseph E. Fineman, Attorney

APPENDIX B

UNITED STATES BANKRUPTCY COURT

FOR THE WESTERN DISTRICT OF KENTUCKY

IN BANKRUPTCY

No. BK 78-00193-L

IN RE:

RIVER REGION MENTAL HEALTH-MENTAL RETARDATION BOARD, INC.—Bankrupt

ROBERT GREENBERG, M.D., Et Al. - - - *Plaintiffs*

v.

RIVER REGION MENTAL HEALTH-MENTAL RETARDATION BOARD, INC. - - - - - - - *Defendant*

MEMORANDUM AND ORDER

Originally, this court's jurisdiction was invoked by the defendant-bankrupt when it commenced a voluntary proceeding by filing an original petition on February 23, 1978, pursuant to Section 322, Bankruptcy Act, seeking financial rehabilitation through an arrangement of its unsecured obligations under Chapter XI of the Bankruntcy Act, 11 U.S.C. §70, *et seq.* For purposes of this memorandum opinion, it is unnecessary to recite the reasons which prevented the debtor from successfully formulating a plan of financial reconstruction.

The debtor, due to circumstances not completely within its control, concluded that revitalization was not a viable alternative, and wishing an orderly liquidation of its assets

moved this Court on July 10, 1978, to have it adjudged a bankrupt. In compliance with the applicable statutory provisions, notice was given all scheduled creditors, and a hearing on the motion was held on July 31, 1978. The Court, having considered all relevant factors, concluded that an adjudication would be in the best interest of the creditors and the estate, and entered an order sustaining the motion on August 2, 1978. As the debtor provided necessary and vital services to the community, the order was made effective and retroactive to midnight July 31, 1978.

A first meeting of creditors was held on August 21, 1978. The last date fixed for filing complaints objecting to discharge and/or for the filing of complaints as provided by Section 17c(2) of the Bankruptcy Act, 11 U.S.C. §35, was set to November 21, 1978. On that date, the plaintiffs filed a complaint which sought, in the alternative: to have the bankrupt held an instrumentality or agency of the Commonwealth of Kentucky; to have the adjudication vacated; to have the discharge denied pursuant to Section 14c(2), Bankruptcy Act, 11 U.S.C. §32; to have their debts found nondischargeable pursuant to Section 17a(2) and (6), Bankruptcy Act, 11 U.S.C. §35; and to have the bankrupt provide an accounting as to wages and other vested interests the plaintiffs were alleged to have in the estate.

On January 11, 1979, a pre-trial conference was held, and the parties were given ninety (90) days to complete discovery. At a subsequent pre-trial conference on April 25, 1979, on application, the parties were given until May 30, 1979, to make additional discovery. The trial of the complaint was then set for July 10, 1979. On May 18, 1979, plaintiffs filed a pleading and supporting memorandum entitled, *"Plaintiff's Suggestion of Lack of Jurisdiction of the Subject Matter."*

The bifurcated trial of the complaint commenced on July 10, 1979, and after four days the plaintiffs having been unable to complete their proof, the trial was adjourned to August 20, 1979. After completion of their case in chief on August 23, 1979, the defendants offered no evidence in rebuttal. The plaintiffs experienced difficulty in effecting service on certain witnesses and securing certain documents, and consequently the Court granted them an additional thirty (30) days to supplement the trial record. The parties were also given the opportunity to file memoranda of authorities and arguments in support of their respective positions. However, only the bankrupt availed itself of this opportunity.

Originally, the bankrupt was incorporated as Kentucky Region Eight Mental Health-Mental Retardation Board, Inc., on June 29, 1966. Approximately one year later, an amendment was made to the Articles of Incorporation changing the name of this non-profit charitable corporation to River Region Mental Health-Mental Retardation Board, Inc. (hereinafter River Region). The name change reflected a revision of state districts that resulted in the region served by the bankrupt becoming Region Six. Non-profit corporations such as River Region are authorized to become bankrupts. Section 4a, Bankruptcy Act, 11 U.S.C. §22, provides that ". . . [a]ny person, except a municipal, railroad, insurance, or banking corporation or a building and loan association, shall be entitled to the benefits of this Act as a voluntary bankrupt." The Act further defines " 'Persons' [to] . . . include corporations, except where otherwise specified . . .", 11 U.S.C. §1(23). This corporate entity alone filed for the protection of the Bankruptcy Act.

River Region was formed to administer mental health and mental retardation services to a seven-county service area. In fulfilling its objectives, River Region provided

services either directly or arranged with specific specialized entities known as affiliate agencies to provide the needed treatment or function through their facilities and personnel, by contract and referral. River Region was the primary provider of comprehensive mental health and mental retardation services to the residents of Jefferson, Trimble, Oldham, Henry, Spencer, Shelby, and Bullitt Counties, and for a time assumed responsibility for the operation of one of the state operated mental hospitals, the former Central State Hospital. The state, however, was forced to resume responsibility when safety code and insurance problems arose with respect to the facility. A central office for the River Region corporation was maintained in Louisville, Kentucky.

River Region's property and affairs were managed by a Board of Directors of the organization, designated as the Regional Mental Health-Mental Retardation Board (hereinafter Regional Board). The Board was composed of not less than twenty-five (25) nor more than forty (40) members. The Regional Board was made up of persons who did not act as representative of any certain agency, profession or organization except to the extent that this cross-section included ten elected chief executives of county governments or their designates. The Board had the exclusive authority to appoint the Executive Director, who was designated the chief operating official of River Region. The executive director was charged with the duty of effectuating the policy set by the Regional Board.

In order for the previous adjudication of River Region as a bankrupt to be vacated, it would be necessary to find that this entity was in reality a state agency or instrumentality, having to file a petition under Chapter IX of the Bankruptcy Act, providing for the adjustment of debts of political subdivisions and public agencies and instrumentalities, and further that the state has consented to the

jurisdiction of this Court pursuant to the Constitution of the United States, as well as the Constitution of the Commonwealth of Kentucky.

Courts have tried to formulate some test to facilitate the decision of whether or not there exists a sufficient connection between an alleged agency and its state in order to find that the action of the agent can be imputed to the state, such that the state bars the liability. Most of these tests have been formulated in the context of civil rights cases resting upon a basis of "state action" or acts performed "under color of law." One such unpublished case in the United States District Court for the Western District of Kentucky was *Joyce Anderson, et al.* v. *North Central Comprehensive Care Center, Inc., et al.*, Case No. C 75-0326-L (B), decision July 22, 1976. Although this was a civil rights action, it involved a similar argument and fact situation to that of the instant case. *Anderson* involved a suit by former employees of the North Central Comprehensive Care Center, Inc., which was a non-profit charitable corporation administering a community health program identical to that administered by the River Region Board and pursuant to the same enabling statutes. The theory was asserted that North Central was in fact a state agency because it was (1) subject to extensive governmental regulation; (2) received a substantial amount in governmental funds; and (3) performed a public function. These arguments are similar to those put forward by plaintiffs in the instant action. The District Court concluded that North Central was not a state agency for the purposes of civil rights statute.

Applying the test of *Anderson, supra,* to the instant facts, the same finding results. River Region was operated pursuant to Kentucky Revised Statutes, §210.370 *et seq.*, and as a non-profit charitable corporation formed under Chapter 273 of the KRS to administer a community mental

health-mental retardation program. While it may be true that Kentucky law placed certain restrictions or limitations on the Board, it is also apparent that this indirect control by the state is insufficient to constitute the entity as a state agency.

The property and affairs of the corporation were managed and controlled by its independent Board of Directors who in turn had exclusive control over the designation of the Executive Director of the Regional Board. The Department for Human Resources which to a large extent funded the activities of the Board would at times require certain formalities as a condition precedent to the state contracting with the Board. However, the relationship of the Department was actually one of lending various types of assistance to the Board, especially in applying for federal funds. These state contracts usually spelled out all federal and state funds the Board was to receive during that fiscal year and the Board's plans for disbursing the money. In other words, the contract detailed what services the state would pay for and the Board's agreement to deliver those services. Not all funding for River Region emanated from the state, and the Board's revenues were received from many diversified entities. Specifically, River Region's sources of income were: federal and state grants; the United Way; local grant and contract payments; Title XIX and Title XX reimbursements; patient fees and miscellaneous contract payors.

Besides contracting with the state to deliver services, the Regional Board also contacted with affiliate delivery agencies as an independent corporate entity. The fact that these contracts were not required to have state approval or sanction further suggests the absence of state "control" over the Regional Board.

A reading of the pertinent statutory authority indicates that River Region could not have been a direct taxing entity

as to classify it a state instrumentality. An ad varolem mental health tax was authorized by the Kentucky Legislature, but it would be implemented only if the Fiscal Court of each county were to enact such legislation. Additionally, the approval of the State Department of Mental Health was a prerequisite. When all steps were taken, a tax could be imposed. These steps were never taken, no taxes were ever levied, and there never existed a mental health and mental retardation taxing district under the direction of River Region.

The final aspect of the state agency test is the question of whether River Region performed a public function. The Court of Appeals for the Sixth Circuit has held that an institution serving an important public function and financed by public funds can be linked with the state for its acts to be subject to Fourteenth Amendment limitations. See, e.g., *Meredith* v. *Allen County War Memorial Hospital Commission*, 397 F. 2d 33 (6th Cir., 1968); *O'Neill* v. *Grayson County War Memorial Hospital*, 472 F. 2d 1140 (6th Cir., 1973). Yet the mere fact that a private organization performs a public function does not, ipso facto, make that organization capable of state action. See *Jackson* v. *Norton's Children's Hospital, Inc.*, 487 F. 2d 502 (6th Cir., 1973); *Blackburn* v. *Fisk*, 443 F. 2d 121 (6th Cir., 1971).

The District Court in *Anderson, supra*, relied on several U. S. Supreme Court cases in concluding that a "public function" may only be found where a private entity exercises powers traditionally exclusively reserved to the States, and further that the provision of mental health care is not traditionally an exclusive state power. Therefore, River Region, a provider of mental health services, did not undertake a "public function" so as to characterize the entity as a state agency.

The final case of *Kentucky Region Eight, et al.* v. *Commonwealth of Kentucky and Kentucky Employees Retire-*

ment System, 507 S. W. 2d 489 (Kentucky, 1974), is dispositive of the issue of whether River Region was a state instrumentality. This case, dealing with the state employee's retirement system, holds that regional mental health-mental retardation boards, as administrators are not state agencies within the purview of the State Employees' Retirement System Act. The Supreme Court of Kentucky set forth the policy for establishing non-profit corporations as administrators of mental health programs:

> "Statements from studies predating the enactment of KRS 210.370 to 210.460 were to the effect that use of nonprofit corporations to implement the program was intended to be an alternative to use of direct state agencies; that the corporations were to be treated as being separate and apart from state government in order to encourage local community support, and to qualify fully for receipt of federal grants and tax-deductible charitable donations."
>
> "The mere fact that the corporations receive and administer grants of state funds does not mean that they are state agencies. *Id.* at 490-491.

It is the conclusion of the Court from the foregoing that River Region does not constitute a state agency or instrumentality; that in view of this fact, the question of state consent to jurisdiction is thereby rendered moot; that the bankrupt properly filed its petition under Chapter XI of the Bankruptcy Act, and further that this petition was properly converted into a Chapter IV proceeding under which defendant was correctly adjudicated a bankrupt.

The Court, having determined that it had jurisdiction to adjudicate the bankruptcy estate of River Region pursuant to Section §2 of the Bankruptcy Act, 11 U.S.C. §11, then entertained proof on the substantive issue of denial

of discharge. Plaintiffs allege in their complaint that the discharge should be denied pursuant to Section 14c(2), Bankruptcy Act, 11 U.S.C. §32, which requires that a discharge be granted unless the bankrupt has ". . . failed to keep or preserve books of account or records, from which his financial condition and business transactions might be ascertained. . . ."

First, it may be helpful to examine the objective sought to be obtained by requiring that a bankrupt preserve account records. The requirement is imposed, in essence, for the benefit of the trustee and the creditors who, with the assistance of proper books and records, may ascertain the true status of the bankrupt's affairs and to test the completeness of the disclosure requisite to a discharge. 1A *Collier ond Bankruptcy,* 14.30.

To satisfy the statutory prerequisite to discharge, the "bankrupt is not required to keep books of a particular kind, according to any set mode or system . . . ; but the books and records must be sufficient to reflect the bankrupt's financial condition and business for a reasonable time prior to the date of adjudication." *Gentile,* 123 F. Supp. 723, citing *In Re LaBelle,* 112 F. Supp. 447 (S. D. Cal., 1953).

In the case at bar, River Region audits were conducted on a regular basis by the accounting firm of Ernst and Ernst for a considerable period prior to the filing of the bankruptcy petition. Those audits, though incomplete in some aspects, are sufficient to meet the statutory burden of an accurate reflection of the financial status of the bankrupt. In addition, since River Region received federal grant funds, a periodic report was produced by and for the Department for Human Resources regarding the operation of the program funded by Title XX of the Social Security Act.

Several awards of fees were approved by this Court for disbursement to Hospital Management Associates under a management service agreement with the debtor in possession. The firm's duties included preparing the final accounting of the debtor in possession. If there had been insufficient financial material for use in the preparation of a final accounting, this process could not have been accomplished. All of the audits and financial records have been preserved and are available at this time.

One final evidentiary fact must be mentioned. The trustee in this case has never asserted that he was unable to ascertain the status of the bankrupt's financial affairs from the existing books and records kept by the entity. Since the rule is, at least in part, for the benefit of the trustee in winding up the affairs of the bankrupt, the trustee's assertion is conspicuous by its absence.

"While it is true that a bankrupt is not required to maintain books in an elaborately scientific and comprehensive form, whether a failure to keep adequate books and records, total or partial, will be justifiable, is a question of fact to be determined in each case, and what would suffice in one, would be hopelessly unsatisfactory in another." *In Re The David L. German Travel Service, Inc.*, 3 BCD 1143 (E.D. Pa., 1977), citing *Karger* v. *Sandler*, 62 F. 2d 80, and *In Re Marx*, 125 F. 2d 335.

If it is found that the bankrupt's financial condition and business transactions can be ascertained from available records and memoranda, his discharge should be granted. 1A *Collier on Bankruptcy*, 14.32.

Rule 407, B.R.P., simply provides that "[a]t the trial on a complaint objecting to a discharge, the plaintiff has the burden of proving the facts essential to his objection." If the plaintiff fails to prove facts which support one of the grounds enumerated in §14c, Bankruptcy Act, the complaint must be dismissed and the bankrupt granted his

discharge. In the instant case, plaintiffs have failed in this burden of proof.

This Memorandum constitutes Findings of Fact and Conclusions of Law pursuant to Rule 752, B.R.P.

For the foregoing reasons, and the Court being otherwise sufficiently advised,

IT IS HEREBY ORDERED AND ADJUDGED that plaintiff's complaint be and is hereby dismissed.

A copy of this Memorandum and Order is mailed to Stuart N. Pearlman; John P. Reisz; John Frith Stewart; Wallace H. Spalding, Jr.; Ryan M. Halloran; David T. Stosberg; and K. Gregory Haynes.

(s) Stewart E. Bland
United States Bankruptcy Judge

Louisville, Kentucky
January 8, 1980 ms

APPENDIX C

UNITED STATES DISTRICT COURT

FOR THE WESTERN DISTRICT OF KENTUCKY

In Re:

River Region Mental Health-Mental Retardation Board, Inc., *Bankrupt.*

In Bankruptcy:

No. BK 78-00193-L

No. C 80-0089-L(B)

Robert Greenberg, M.D., et al. - - - *Appellants*

v.

River Region Mental Health-Mental Retardation Board, Inc., - - - - - - - - - - *Appellee*

MEMORANDUM

This matter is before the Court on appeal from the order of Bankruptcy Judge Bland dismissing appellants' complaint seeking to have the bankrupt held to be an instrumentality of the Commonwealth or, in the alternative, to vacate the adjudication of bankruptcy. Appellants sought to have the discharge denied for failure adequately to maintain books of account, Repealed Title 11 U.S.C. App. Section 32(c)(2), and to have certain debts declared non-dischargeable under Section 35(a)(2) and (6).

The record in this case is mammoth[1]. In an effort to keep this memorandum within manageable bounds, the Court will digest the record as much as possible.

The bankrupt was incorporated as Kentucky Region Eight Mental Health-Mental Retardation Board, Inc., a nonprofit charitable corporation in 1966. About a year later its articles of incorporation were amended to change its name to River Region Mental Health-Mental Retardation Board, Inc. (hereafter River Region). River Region was established to administer mental health and mental retardation services in Jefferson County and 6 neighboring counties. To carry out its purposes River Region either provided direct services or arranged with specialized facilities to provide treatment or services. The affiliate agencies rendered treatment either by contract or by referral.

River Region, as a part of its services, for a time assumed operation of Central State Hospital, the name of which was changed to River Region Hospital. After River Region encountered substantial difficulty with safety code violations and the obtainment of medical malpractice insurance, it turned the facility back to the Commonwealth which resumed operation of the hospital. River Region was operated by a Board of Directors made up of 10 elected officials or their designees and between 15 and 30 representatives of the communities served by River Region. The Board had the exclusive power to name an executive director to be responsible for the operation of the corporation. The executive director was specifically charged with implementation of board policy.

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[1]While the Court does not have a scale readily at hand, we will stack this record up against any our colleague Judge Gordon has weighed.

Appellants argued before Judge Bland that River Region was in reality an agency of the Commonwealth and thus within the provisions of Chapter 9 of the Bankruptcy Act. To reach a decision of the efficacy of this argument perforce requires a discussion of some of the hundreds of pages of testimony introduced before Judge Bland.[2]

The first witness who testified was Dr. Joseph Maloney. Despite the persistent efforts of appellants' counsel to prove by the witness that River Region was a de facto state agency, after 115 pages of transcript, punctuated by repeated acrimonious exchanges between counsel for appellants and counsel for appellees,[3], Dr. Maloney presented no competent evidence from which it could be concluded that River Region was a state agency.

Appellants next called Robb Smith, an attorney who had served as a board member of River Region from 1976 to 1978. He was Chairman of the Board from the Spring of 1977 until August 1, 1978. Smith testified that River Region was established as a nonprofit corporation pursuant to Chapter 273 KRS. He conceded that the corporation was subject to regulation by the Commonwealth, hardly a mind-boggling revelation.

Mr. Smith's testimony, like Dr. Maloney's, was constantly interrupted with rancorous interchanges, and it may be summarized by saying that there was no competent evidence adduced from which a factual determination could be made that River Region was a state agency.

Appellants next called William Thomas Burkett, Inspector General of the Department for Human Resources

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[2]We have not weighed the record as is the custom in some areas of this District. We would note, however, that the Transcript of Proceedings before Judge Bland stands 7 inches tall.

[3]At page 102 of Volume II of the Transcript, Judge Bland was goaded to observe, "This is getting totally out of hand."

(DHR). Burkett's testimony followed the same pattern set by Maloney and Smith — that is, about one page of testimony followed by three pages of bickering and repeated admonitions by Judge Bland to counsel for appellants. Nothing in his testimony can be construed to lend weight to appellant's argument that River Region was in fact an agency of the state.

Appellants next witness was Reverend Jerry Eifler (referred to in the transcript as "Eikler"). Father Eifler's testimony — punctuated by the customary repeated interruptions, arguments and admonitions — in substance revealed that he resigned from the River Region Board because he felt unwarranted pressure from DHR. This conclusion on Father Eifler's part may have been sincerely felt but it is insufficient to support a finding that River Region was a state agency.

Following Father Eifler appellants called Dr. James Halikas, former Executive Director of River Region. The proceedings as they pertained to Dr. Halikas and his testimony might most charitably be termed stormy. There was little actual testimony from Dr. Halikas but there is ample repetition of the pattern established during the testimony of previous witnesses. None of the meager competent evidence elicited from Dr. Halikas is sufficient to compel the conclusion that River Region is a state agency. In lengthy avowal testimony Dr. Halikas drew the ultimate conclusion that River Region was in fact a state agency. This conclusion is buttressed by several opinions of the Attorney General of Kentucky which, of course, are of no binding effect.

Appellants' next witness was Ashar Tullis, Executive Director of the Mental Health Association of Kentucky. Mr. Tullis managed to produce 9 pages of testimony (most of which was interesting but totally irrelevant) before the hearing deteriorated into the customary brouhaha. Exam-

ining Mr. Tullis' testimony in chief and on avowal fails to convince the Court that it mandates a finding that River Region was a state agency.

Appellants, in Volume VII of the transcript (a paltry 57 pages), asked four questions of Becky Bryant of the Marshal's Office and established beyond a reasonable doubt that the United States Marshal's Service had been unable to serve Peter Conn, Secretary, DHR, and Commissioner Robert Slayton, Mr. Conn's Deputy. The remaining portion of the volume was an echo of the previous six volumes.

Appellants called James H. Rittenberry, who had been Director of Finance and Administration Control of River Region and Acting Executive Director for a short period of time following Dr. Halikas' departure. His testimony followed the already-discussed course of every other witness. It may be said that neither his proof in chief nor his 63 pages of avowal testimony conclusively establishes that River Region was a state agency.

Appellants next called Dr. Howard Frank Bracco, Assistant Executive Director of River Region. Dr. Bracco's testimony in chief gives little comfort to appellants. He simply had no knowledge of the Commonwealth's role in the operation of River Region. His avowal likewise demonstrates that he did not consider himself to be a state employee, nor did he represent to any prospective employee that he or she would be a state employee. The substance of the avowal does more mischief to appellants' argument than it lends support.

Elaine Musselman, a former member of the River Region Board of Directors, refused to testify that River Region was considered as a state agency by the Board members. The strongest statement she made was that she felt, "as if it were a quasi-governmental organization." (T.E. VIII, pg. 215.) She felt, however, that the Board had the final responsibility and could go against the State's

dictates. (Id. pgs. 216, 217). In sum, appellants would have been better off had Ms. Musselman been as difficult to subpoena as were Conn and Slayton.

Volume IX of the transcript contained testimony going to appellant's argument against dischargeability. Appellants have argued that River Region should not be discharged since it: "(2) destroyed, mutilated, falsified, concealed, or failed to keep or preserve books of account or records, from which his financial condition and business transactions might be ascertained, unless the court deems such acts or failure to have been justified under all the circumstances of the case; . . . ."

In support of their argument that discharge should be denied appellants introduced the testimony of Ronald W. Rowe, a certified public accountant associated with Ernst & Ernst. He testified that Ernst & Ernst was retained by DHR to audit River Region's books of April 30, 1976.[4] He testified that the records of River Region were adequate for the purpose of allowing him to draw a conclusion as to the fairness of the accounts receivable. Rowe found some areas of uncertainty in his audit but he felt that accounting controls were adequate for audit purposes. He finally concluded that the books of River Region could have been closed based on the records available.

The next witness called was Lawrence Bloemer, a food distributor to whom River Region was indebted. After eight pages of colloquy, Mr. Bloemer was excused, having added nothing of note to the record.

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[4]Rowe's testimony was periodically interrupted by the appearance of numerous persons who entered the courtroom in response to a letter inviting them to attend the trial. These individuals were apparently creditors of River Region. Their appearance triggered another confrontation between counsel for appellants and counsel for appellee. After a recess to unruffle feathers, Mr. Rowe's testimony was resumed.

Appellants' next witness was Rita Turner, who had worked in the pre-school program of one of River Region's areas. She testified that computer printouts were often delayed and sometimes contained inaccuracies. Her testimony was insufficient to support a finding that River Region's discharge should be denied under Section 32(c)(2), supra.

Appellants next called Denise Rinehart, a therapist who testified as to billing difficulties she had encountered. She testified as to what might be termed slipshod practices she had heard about and in which she had been asked to participate but refused. Her testimony was at best inconclusive as to the question of River Region's bookkeeping practices.

Albert Perkins, appellants' next witness, added nothing to the Section 32(c)(2) issue.

Robert Ayre, an accountant employed by River Region, testified that the journal entries which went into the general ledger were in disarray but that as of June 30, 1977, the books were finally balanced. The essence of his testimony was that, despite slipshod accounting practices, he was able to balance River Region's books.

River Region's personnel officer, Marilyn Heath, testified that she observed some irregularities in bookkeeping but her testimony is of insufficient weight to counterbalance the testimony of Mr. Rowe and Mr. Ayre that the books were finally balanced.

Appellants final witness, Keith Wilkie, added little to the record except to establish that he was responsible for processing the purchase orders issued by River Region.

The Court has considered the lengthy avowal testimony of Rita Turner and Marilyn Heath and finds that it was properly excluded.

All of the foregoing is a skeletal resume of the 1615 pages in the transcript of the proceedings before Judge Bland.

We note at the outset that it is well settled that the Bankruptcy Judge's Findings of Fact must be accepted unless they are clearly erroneous. *McDowell* v. *John Deere Industrial Equipment Co.*, 461 F. 2d 48 (6th Cir. 1972); *In Re Albert-Harris, Inc.*, 313 F. 2d 447 (6th Cir. 1963). Rules Bankr. Proc., Rule 810, Title 11 U.S.C.

While there is ample evidence of state supervision, we cannot say that the Bankruptcy Judge's determination that River Region was not a state agency was clearly erroneous. Appellants argue that whether a commission or agency is a separate and identifiable entity is a question of state law, citing *Ward* v. *Louisiana Wildlife and Fisheries Commission*, 347 F. 2d 234 (5th Cir., 1965).[5] Conceding the validity of this argument, we believe that appellants are now between a rock and a hard place. In *Kentucky Region Eight* v. *Commonwealth*, Ky., 507 S. W. 2d 489 (1974), the Kentucky Court of Appeals, then the Commonwealth's court of last resort, wrote:

> "The mental health-mental retardation corporations here involved are not claimed to be state agencies for any purpose other than retirement system participation. Their employes are not under the merit system, state salary schedules, or any other state personnel regulations. In our opinion it is inconceivable that KRS 61.510 could have been intended to bring into the Kentucky Employes Retirement System persons who are not considered state employes for any other pur-

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[5]The case cited by appellants is a per curiam order affirming the District Court which authored the quote in appellants' memorandum. *See Ward* v. *Louisiana Wildlife and Fisheries Commission*, 224 F. Supp. 252 (E.D. La. 1963).

> pose. We think that 'state department or board or agency' as used in KRS 61.510 plainly means departments, boards or agencies that are such integral parts of state government as to come within regular patterns of administrative organization and structure and to be subject to standard personnel policies having general application in the administration of government." 507 S. W. 2d at 491.

Appellants would have us construe this holding more narrowly than we believe is proper. We believe the holding is plain and unambiguous.

Appellants have cited a number of cases holding various entities the instrumentalities of the State. We have no quarrel with the holding in those cases. We believe they are distinguishable in that the agencies were entirely subject to governmental control, an element lacking in the case at bar.

We conclude that Judge Bland's findings are not clearly erroneous and, indeed, are adequately supported by the record.

We turn next to the matter of River Region's books. While the record-keeping practices were less than exemplary, the accountants who testified were able to balance the books. We believe the language from *Matter of Decker*, 595 F. 2d 185 (3rd Cir. 1979), is dispositive of appellants' argument:

> "Section 14a of the Bankruptcy Act, 11 U.S.C. § 32(a), provides that 'the adjudication of any person, except a corporation, shall operate as an application for a discharge.' A bankrupt is entitled to a discharge unless the court is satisfied that the bankrupt has committed one of the acts listed in section 14c. Here, the Trustee filed a complaint under section 14c(2). To

prevail, the Trustee must show that the Bankrupt failed to keep or preserve books of account or records and that the failure makes it impossible to ascertain the financial condition and material business transactions of the bankrupt. (Citations omitted.) While 'the statute does not exact as a condition precedent to the granting of a discharge the keeping of an impeccable system of bookkeeping which would meet the approval of a skilled accountant or records so complete that they would satisfy an expert in business,' the records must 'sufficiently identify the transactions that intelligent inquiry can be made of them.' *Johnson* v. *Bockman,* 282 F. 2d 544, 546 (10th Cir. 1960). The test is whether 'there [is] available written evidence made and preserved from which the present financial condition of the bankrupt, and his business transactions for a reasonable period in the past may be ascertained.' *In re Underhill,* 82 F. 2d 258, 260 (2d Cir.), *cert. denied,* 299 U. S. 546, 57 S. Ct. 9, 81 L. Ed. 402 (1936).

While the trial court has wide discretion in determining whether the books or records are sufficient within the meaning of the statute, *Goff* v. *Russell Co.,* 495 F. 2d 199, 202 (5th Cir. 1974), this court has stressed the 'well-settled principles that the right to a discharge is statutory, and that Section 14 of the Bankruptcy Act must be construed strictly as against the objector and liberally in favor of the bankrupt.' *In re Leichter,* 197 F. 2d 955, 959 (3d Cir. 1952), *cert. denied,* 344 U. S. 914, 73 S. Ct. 336, 97 L. Ed. 705 (1953)." 595 F. 2d at 187.

See also *In the Matter of Gentile,* 123 F. Supp. 723 (W.D. Ky., 1954).

We conclude that appellants have failed to sustain their burden.

In conclusion, the Court finds that the findings of the Bankruptcy Judge are not clearly erroneous and his order dismissing appellants' complaint will be affirmed in all respects.

An appropriate Order has been entered this date.
September 11, 1980

(s) Thomas A. Ballantine, Jr.
United States District Judge

Copies to:

Counsel of record

APPENDIX D

UNITED STATES COURT OF APPEALS

FOR THE SIXTH CIRCUIT

No. 80-5433

JAMES A. HALIKAS, M.D., - - *Plaintiff-Appellant*

v.

RIVER REGION MENTAL HEALTH-MENTAL RETARDATION BOARD,

RIVER REGION MENTAL HEALTH-MENTAL RETARDATION BOARD, INC.,

WALLACE A. SPALDING, TRUSTEE,

COMMONWEALTH OF KENTUCKY, EX REL, DEPARTMENT OF HUMAN RESOURCES, - - *Defendants-Appellees.*

ORDER — Filed October 19, 1891

This matter is before the Court for consideration and determination of the request from Seven Counties Services that it is not a party to the proceedings in the instant appeal and to be eliminated from the appeal and all responsibilities regarding this appeal, accordingly,

It is ORDERED that the request is granted and that Seven Counties Services is eliminated as a party in this appeal.

ENTERED BY ORDER OF THE COURT.

(s) John P. Hehman, Clerk

APPENDIX E

UNITED STATES COURT OF APPEALS

FOR THE SIXTH CIRCUIT

80-5433

JAMES A. HALIKAS, M.D., - - *Plaintiff-Appellant,*

v.

RIVER REGION MENTAL HEALTH-MENTAL RETARDATION BOARD,

RIVER REGION MENTAL HEALTH-MENTAL RETARDATION BOARD, INC.,

WALLACE A. SPALDING, TRUSTEE, SEVEN COUNTIES SERVICES, INC.,

COMMONWEALTH OF KENTUCKY, EX REL, DEPT. FOR HUMAN RESOURCES, - - *Defendants-Appellees.*

ORDER — Filed October 22, 1981

Before: KEITH and KENNEDY, Circuit Judges, and COWEN*

Plaintiff-appellant James Halikas ("Halikas") appeals from a federal district court's order affirming the ruling of a bankruptcy court.

On February 23, 1978, River Region Mental Health-Mental Retardation Board, Inc. ("River Region") filed for Chapter XI relief under the Bankruptcy Act of 1898. On July 10, 1978, River Region filed a motion to convert the

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*Hon. Wilson Cowen, Senior Judge, Court of Claims, Washington, D.C., sitting by designation.

Chapter XI case to a straight bankruptcy. It also asked for an adjudication that it be declared bankrupt.

On July 31, 1978, Robert Greenberg, on behalf of all present and prior psychiatrist/employees of River Region, filed an "Objection to Adjudication as Bankrupt." These plaintiffs contended that the adjudication of River Region as bankrupt would be improper since it was an agency for the Commonwealth of Kentucky. Halikas later joined in this objection. The Bankruptcy Court conducted a hearing. On August 2, 1978, River Region was adjudicated bankrupt as of July 31, 1978.

On November 27, 1978, the Bankruptcy Court issued a summons and notice of pretrial conference to River Region. The Court enclosed the Plaintiffs' Complaint to Deny Discharge, Determine Debt to be Non-Dischargeable and For Judgment.

Plaintiffs' Complaint was similar to their July 31, 1978 objection. The Complaint also alleged that River Region failed to keep, maintain and/or provide adequate books and records. Finally, it alleged that the information contained in the bankrupt's books was inaccurate, misleading or deliberately fraudulent as to the plaintiffs.

On June 21, 1979, plaintiffs' counsel wrote the Attorney General of Kentucky and asked him to intervene in the case on the ground that River Region was a state agency. The Kentucky Attorney General, however, declined to intervene.

On July 10, 1979, a bifurcated trial was commenced. First, the Bankruptcy Court addressed the issues of whether it had jurisdiction over River Region and whether River Region was a state agency. Second, the Court addressed the issue of whether River Region had maintained adequate books and records.

On January 8, 1980, the Bankruptcy Court dismissed the plaintiffs' Complaint. On January 22, 1980, the plain-

tiffs filed their notice of appeal, which was docketed in the United States District Court for the Western District of Kentucky.

On September 11, 1980, the District Court affirmed the Bankruptcy Court's order in all respects. On October 14, 1980, Halikas filed a notice of appeal with the District Court, which was docketed as No. 80-5404. On October 24, 1980, the District Court denied the plaintiffs' request for reconsideration and request for findings of fact and conclusions of law.

On November 18, 1980, Halikas again filed a notice of appeal, which was docketed as No. 80-5433. That case is now before this Court. On March 12, 1981, Halikas filed with this Court a preliminary brief pursuant to Fed. R. App. P. 30(c); a designation of record; and a motion and order requesting this Court to vacate the adjudication, to dismiss the bankruptcy petition for lack of subject matter jurisdiction. Halikas also moved to maintain pendent jurisdiction and issue a writ of mandamus.

By order dated April 13, 1981, the appeal docketed as No. 80-5404 was dismissed for want of jurisdiction. It was noted that the appeal docketed as No. 80-5433 was currently pending. On April 21, 1981, this Court reserved judgment on Halikas' motions to vacate, dismiss, retain pendent jurisdiction and issue a writ of mandamus.

On this appeal, Halikas contends that the Bankruptcy Court did not have subject matter jurisdiction. He also contends that River Region failed to maintain adequate books and records. After considering the briefs, record and oral arguments, we affirm the judgment of the District Court.

ENTERED BY ORDER OF THE COURT

(s) John P. Hehman
Clerk

APPENDIX F

[LETTERHEAD OF UNITED STATES COURT OF APPEALS]

January 12, 1982

Mr. Stuart N. Pearlman
Mr. David T. Stosberg
Mr. Ryan M. Halloran
Mr. John P. Reisz

Re: Our Case No. 80-5433
James A. Halikas, M.D. v. River Region Mental Health, et al.
District Court Number 80-00089

Dear Counsel:

Enclosed is a copy of an order which was entered today in the above-styled case.

Very truly yours,
John P. Hehman, Clerk

By (s) Barbara J. Burns
(Mrs.) Barbara J. Burns
Deputy Clerk

Enclosure

F2

No. 80-5433

UNITED STATES COURT OF APPEALS

FOR THE SIXTH CIRCUIT

JAMES A. HALIKAS, M.D., - - *Petitioner-Appellant,*

v.

RIVER REGION MENTAL HEALTH-MENTAL RETARDATION BOARD,
RIVER REGION MENTAL HEALTH-MENTAL RETARDATION BOARD, INC.,
WALLACE A. SPALDING, TRUSTEE, SEVEN COUNTIES, SERVICES, INC.,
COMMONWEALTH OF KENTUCKY, EX REL, DEPT. FOR HUMAN RESOURCES, - - *Defendants-Appellees.*

ORDER DENYING PETITION FOR REHEARING
—Filed January 12, 1982

Before: KEITH and KENNEDY, Circuit Judges, and COWEN*

Upon consideration of the petition for rehearing, the above panel concludes that it is without merit.

Accordingly, it is ORDERED that rehearing be and hereby is denied.

ENTERED BY ORDER OF THE COURT

(s) John P. Hehman
Clerk

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*Hon. Wilson Cowen, Senior Judge, Court of Claims, Washington, D.C., sitting by designation.

APPENDIX G

NEWS RELEASE

[LETTERHEAD OF THE SECRETARY OF HUMAN RESOURCES COMMONWEALTH OF KENTUCKY]

Contact: Joan Riehm
588-4792 (6/29)
564-7130 (6/30)

Louisville, Ky. (June 29, 1978)—State Human Resources Secretary Peter Conn announced today that the State is withdrawing designation from the River Region Mental Health-Mental Retardation Board in Jefferson County as the authority for delivering community mental health and mental retardation services in Jefferson and the six surrounding counties.

Beginning August 1, 1978, the State's designation—which makes possible the receipt of federal and state mental health and mental retardation funds — will go to a new nonprofit organization formed by area residents. Conn made the announcement at an 11 a.m. news conference today in Louisville.

The new agency, called Seven Counties Services, Inc., will insure the continuation of community mental health and mental retardation services provided by River Region in the seven-county area around Louisville, involving the counties of Bullitt, Henry, Jefferson, Oldham, Shelby, Spencer and Trimble.

Conn noted tht River Region's problems go back several years, and that the state has intervened numerous times to help the agency during the past two years. State assistance has included taking over the operation of Central State Hospital in Jefferson County from the agency last year; making several funding advances against future earnings;

giving grants of more than $2 million to River Region; and speeding up the processing of all of the agency's billings for the past year.

The culmination of problems came this week with the completion of a State audit of River Region showing that the agency has potential debts amounting to $6 million.

"We feel that the credibility of River Region has been so badly damaged, and its fiscal obligations are so great, that it is not possible to restore a balanced budget and a stable administration," Conn said. "As a result of this situation, services will decline and talented staff will continue to leave."

"The State's primary responsibility is to ensure the delivery of quality community mental health-mental retardation services to this area," Conn continued. "I no longer believe this can be done effectively through the River Region Agency."

The new agency, Seven Counties Services (SCS) "will provide and strive to improve services throughout the seven-county area," Conn said. "It will operate with a balanced budget. Its Board of Directors and staff will have direct access to quality medical and other professional advice."

"Most important," he added, the new agency "will represent a fresh start, a new beginning, for delivering mental health and mental retardation services to this area."

Conn said the emphasis during the transition period from River Region to the new agency will be on continuing services at their current level. He said he has asked the cooperation of the present River Region Board in continuing operations during July, and also talked with representatives of the River Region staff. The mapority of River Region's staff are expected to be needed by the new agency, and all are being encouraged to apply for positions.

The members of the Board of Directors of Seven Counties Services, Inc., had their first meeting yesterday afternoon. They will form the nucleus of a citizens Board of Directors who will elect other members from throughout the seven-county area.

Officers elected are: Chairman, Dr. Joseph F. Maloney, Director of the University of Louisville's Institute for Community Development; Vice-Chairman, Gerald Kirven, a Louisville attorney who is vice-president of the Kentucky Association for Mental Health; Secretary-Treasurer, Joseph Robinson, Director of Guidance for the Jefferson County Board of Education.

Other Board members are: Mrs. Coleman (Jean) Sibley of Trimble County; John Crockett, Vice-President of the First National Bank of Louisville; Mrs. Robert (Jean) Tillett and Mrs. V. Joseph (Peggy) Shipman, both Board members of the Louisville Area Association for Mental Health; Paul Shepherd, District Superintendent of the Louisville North District, United Methodist Church; and James Thompson, Chairman af the Board of Glenmore Distilleries Co. in Louisville.

Conn said Seven Counties Services will have a professional advisory committee to work with its Board and staff. The committee will include professionals from the mental health-mental retardation field, and a special medical advisory group composed of four local psychiatrists.

The medical advisory committee, to be headed by Dr. John Bell of Louisville, will evaluate existing medical services and help design improved systems for service delivery. Other committee members are Dr. Frank Gaines, Dr. Warren Cox and Dr. Patrick Galla. The committee also will advise the Board in selecting a Medical Director, who will assure quality medical services for SCS.

Conn praised the employees and staff of River Region who, he said, "have done a remarkable job of maintaining

quality services during an extremely difficult period." He commended River Region's Board of Directors for serving unselfishly and with dedication."

And Conn said Hospital Management Associates, the management firm hired by River Region after it declared bankruptcy, had made improvements in accounting and budgeting procedures.

"We hope," he concluded, "that the spirit of dedication and hard work that has kept River Region in operation during these last difficult months will be the foundation for a new start for community mental health-mental retardation services in this area."